



A Statement of Principles and Direction for the Plan Design of SDRS

**Prepared by the South Dakota Retirement
System Board of Trustees**

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Introduction

By the end of 1974, SDRS was well into its first year, and much of the controversy over the consolidation of South Dakota's 11 public retirement plans had subsided. The test, however, of whether this bold experiment could succeed had just begun. Would benefits be large enough to support a member in retirement? Would combining systems increase administrative efficiencies? Could the system pay the substantially improved benefits and still remain solvent? Could the board develop benefit packages that satisfied members of different ages, salary levels and years of credited service? Could new benefit packages achieve the flexibility necessary to adapt to major changes in members' work and personal circumstances? Could the system withstand major losses in the capital markets and remain financially sound?

Thirty years later there are definitive answers to these questions:

- Career employees earning an average salary can expect combined SDRS and Social Security benefits equaling 70 to 85 percent of their working salary
- The ratio between the costs of administration and the dollars paid in benefits has fallen by nearly 90 percent
- The system's assets approximately equal liabilities, even after a sustained period of poor market returns
- Benefits for both retirees and active members, at all income levels and with widely differing years of service, have dramatically increased

But not surprisingly, the debate over the fundamental issues surrounding SDRS continues. The Legislature, board members, and a well-informed membership are revisiting many of the decisions that shaped the system in 1974. Issues such as:

- How to balance the concern for equity in the system while addressing the special needs of members who, for example, are disabled, die leaving a surviving family or are only employed for a short time
- How to measure the adequacy and equity of the system's benefit formulas
- How to keep equity between Class A and Class B classifications

In an effort to answer questions like these, SDRS has focused its energies and resources on developing innovative approaches to its plan design. It systematically researches and studies “best practices” in the industry, diligently involves its employer and employee members in determining how new approaches can be adapted to SDRS and carefully communicates the rationale behind those approaches. In addition, the system has actively participated in major retirement studies or reviews.

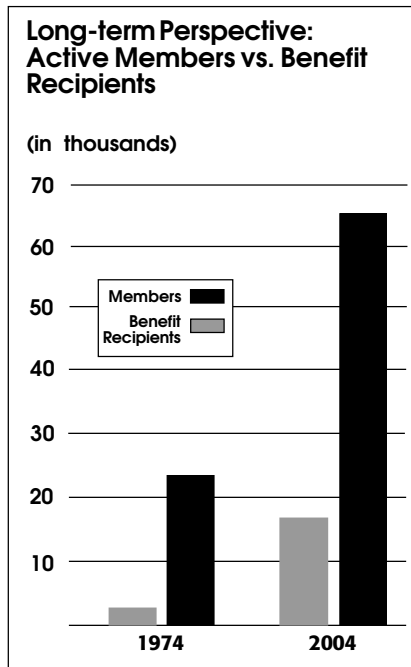
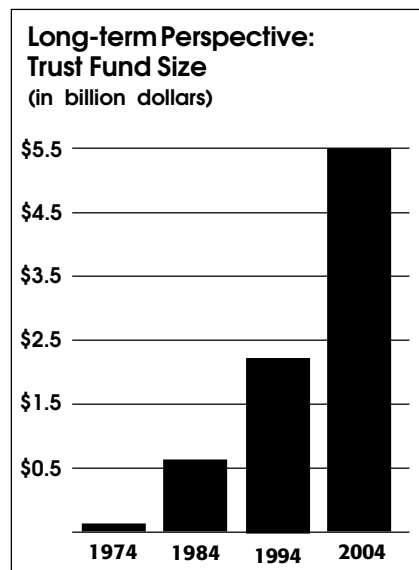
This white paper is an extension of this process. It presents the arguments regarding the advantages of SDRS’ hybrid plan design in comparison to plans with only defined-contribution and defined-benefit features. The paper contains a description of the evolution of SDRS from its creation in 1974 to the present, a discussion of the two most common alternatives in plan design and a description of the hybrid qualities of SDRS. It concludes with a list of key positions with regard to SDRS and its benefit structure formally adopted by the SDRS Board.

The Evolution of a System

When the Legislature created SDRS in 1974, the system faced a number of challenges and uncertainties. Assets were low and obligations high. Benefit formulas, though substantially better than those of the plans SDRS replaced, were marginal, and the number of members receiving benefits totaled less than 3,000. Moreover, one of the compelling reasons for consolidation, savings in administrative costs was, as yet, a theory with no hard facts to give it substance. But as months and years elapsed, the landscape began to change, and growth – sometimes phenomenal growth – became the hallmark of SDRS.

Membership

For example, in 1974, 23,500 public employees were part of the system, of whom 2,900 were receiving benefits. By 2004, the membership had jumped to 65,555, including 17,029 benefit recipients – a stunning increase of 179 percent in the general membership and 487 percent among benefit recipients.



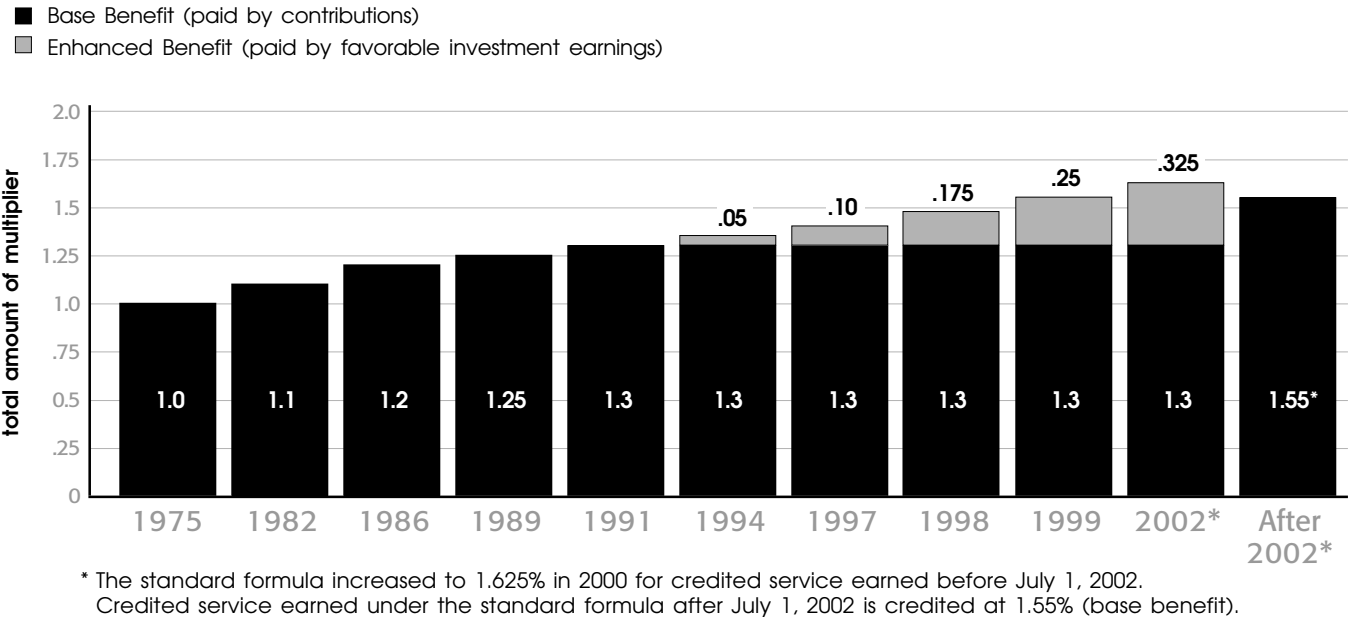
Trust Fund

The surge in the number of members has been matched by increases in the system's trust fund. Exclusively set aside to pay promised benefits, the fund has swelled to 86 times its original size. Beginning at \$56 million, the fund now stands at \$5.5 billion.

Benefit Improvements

Equally impressive growth has come in the area of benefit improvements. For example, the Class A benefit formula, which began with a 1.0 percent multiplier, rose to 1.625 percent for service prior to July 1, 2002, an increase of 63 percent. In 2002, the multiplier for all credited service earned after July 1, 2002 increased from 1.3 percent to 1.55 percent.

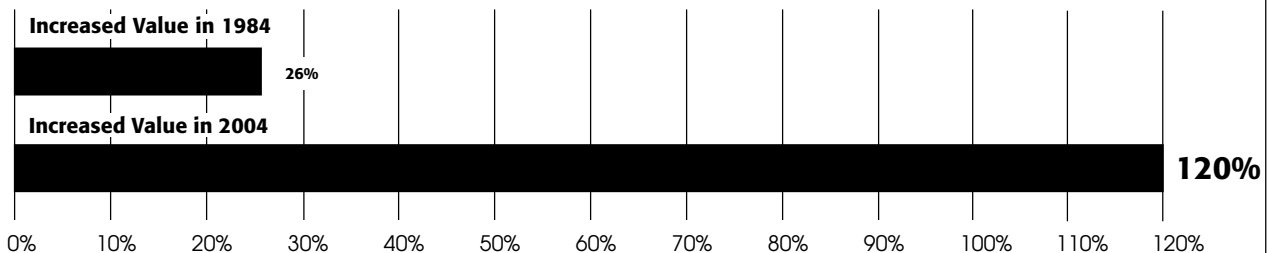
Class A Benefit Formula Changes: 1975 – Present



The annual cost-of-living adjustment has expanded from 2.0 percent simple interest to 3.1 percent compounded interest, and penalties for early retirement have been reduced significantly.

Combined, these benefit improvements are valued at \$1.4 billion. (This means that a member in 1984 would have received a benefit whose future value was 26 percent higher than the original SDRS benefit. By 2004, that value had increased 120 percent above its original amount, or more than double in value.) As a result, SDRS' annual payments to its members now rival the payrolls of the very largest corporations in the state.

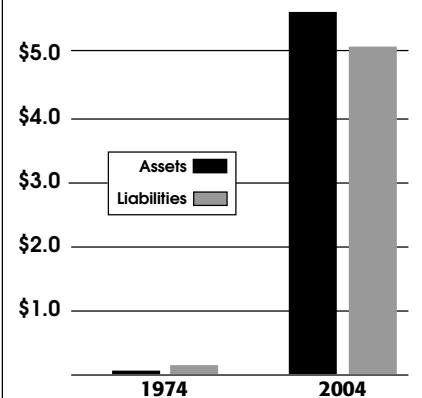
Value of SDRS Benefits Increases 120% Since 1974



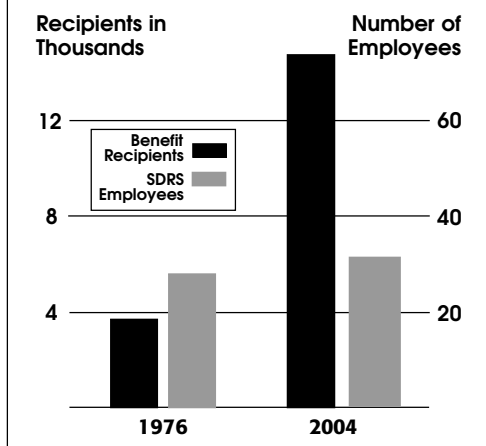
Asset and Benefit Liability Comparison

While increases in membership, trust fund balances, benefit improvements and benefit payments demonstrate the system's growth, the best measure of SDRS' financial strength comes from a comparison of its assets and liabilities. In 1974, SDRS had just over \$1 in its trust fund for each \$2 it had promised to pay its members in benefits. Expressed as a ratio, assets covered only 53 percent of the system's liabilities. By 2004, however, that ratio had climbed to 109 percent, making SDRS one of the most financially sound systems in the nation.

**Long-term Perspective:
Ratio of Assets to Liabilities**
(in billion dollars)



SDRS Workload Analysis: Benefit Recipients to SDRS Employees



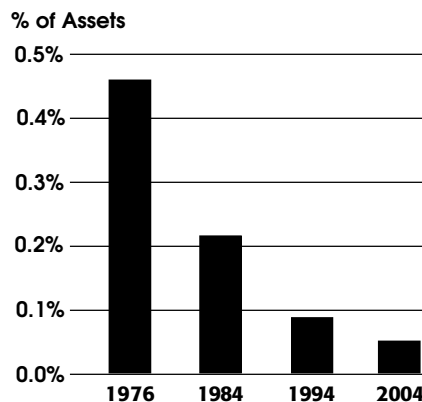
Administrative Efficiency

Fortunately, the efficiency of SDRS' administrative structure has kept up with the growth in the system's membership and subsequent need for services. In 1976 SDRS employed 27.2 full-time employees. In the meantime, between 1976 and 2004, the workload of the system more than tripled. For example, the number of SDRS benefit recipients, the segment of the membership that generates the most work, increased

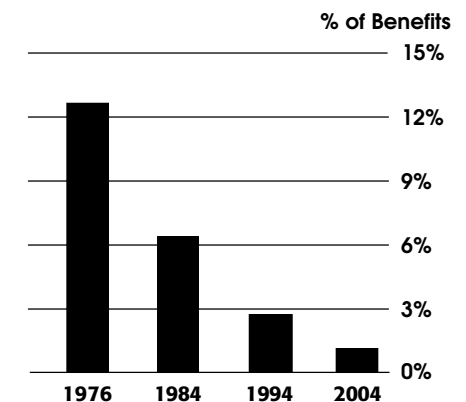
from 3,842 to 17,028. But during the same time period, the number of SDRS employees remained virtually constant, increasing by only one employee.

Three other key indicators of administrative performance underscore the system's efficiency. The first is the ratio of SDRS' expenses compared to the assets in the trust fund. The second is the ratio of expenses compared to the amount of benefits SDRS pays during a year. Both of these indicators have dropped by more than 90

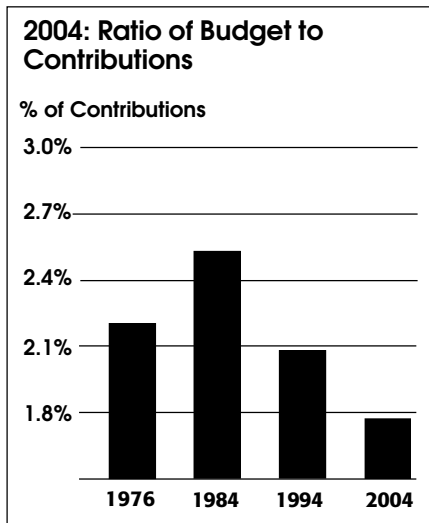
SDRS: Ratio of Expenses to Assets



SDRS: Ratio of Expenses to Benefits Paid



percent since 1976. The third compares the size of the system's operating budget to the amount of contributions made by the membership. While state law allows 3 percent of contributions to be used for administration, the FY2004 budget approved by the legislature was only 1.5 percent of contributions.



As noted in the chart located on the previous page, SDRS' administrative expenses in FY2004 were .055 percent of assets. A 2001 Buck Consultants "Survey of Large Municipal, County and State Retirement Systems" found that the overall average administrative expense (without any investment expenses) for systems in the survey was .264 percent of assets. SDRS administrative expenses are approximately 78 percent less than the average cost of the surveyed plans.

Growth and change in SDRS add up to an evolutionary process that has made the system highly successful. This evolution has occurred through a thoughtful decision-making process carried out by the SDRS Board of Trustees, staff and the Legislature.

This analytical approach is apparent whenever the Legislature and board consider the basic forms of retirement plans and the implications each carries for the financial future of the membership.

Alternatives to SDRS: Two Traditional Philosophies of Retirement Plan Design

Over the last several years, the popular press was proclaiming that a historic shift was taking place in the retirement

industry. Experts were citing statistics that showed an exodus from defined-benefit plans to defined-contribution plans.¹ They noted a wide range of causes for what was termed a revolutionary change:

- an onslaught of federal regulations and paperwork imposed on private sector defined-benefit plans
- a more mobile work force and the need for greater plan portability
- exceptional performance of the capital markets through the late '80s and '90s
- employer cost-control measures resulting in a transfer of both costs and risk for adequate retirement benefits to employees

More recently, however, retirement professionals have diluted this revolution to a “significant trend.” These are the facts on retirement plans in the United States:

- Only 50 percent of the work force is covered by any plan.
- Over 86% of public employees who participate in a retirement income plan participate in a defined-benefit plan.
- Overall, the participation in defined-benefit plans and defined-contribution plans (as the primary retirement income plan) is about equal.
- Capital markets can experience substantial volatility (2000-2002), making defined contribution plans much less attractive.

The growth in defined-contribution plans occurred primarily within smaller businesses. Moreover, many companies that have begun defined-contribution plans have made them additions to rather than substitutions for their defined-benefit plans.

Although SDRS is neither a pure defined-benefit or defined-contribution plan, a comparison of the characteristics of the two approaches is fundamental to an understanding of SDRS' unique design.

¹ A defined-benefit plan is an employer-managed retirement plan in which income for retirement is provided to the employee by a guaranteed benefit for life based on years of service, final salary, and a percentage multiplier. A defined-contribution plan is an employee-managed retirement plan in which income for retirement is determined by the total dollars contributed to an account by an employee (and sometimes an employer), plus the dollars an employee earns on the investment of those contributions.

Defined-benefit Plans Have Advantages for Long-term Employees

- Guaranteed lifetime income
- Maximized retirement benefits
- Tool for retention
- Certain and predictable costs
- Inflation protection
- Employer/sponsor assumes investment and actuarial risk
- Benefits can exceed contributions to plan
- Greater investment return than those of employee-directed plans

Plans Designed to Benefit Long-term Employees

The benefit structure of defined-benefit plans targets long-term employees. Unlike SDRS, in their pure form defined-benefit plans make no concessions to short-term employees and, consequently, can offer a number of distinct advantages to career employees, as shown in the chart at left.

Defined-benefit plans give full control over the management of the plan to the employer/sponsor, including

contribution levels, benefit levels and the choice of investments. In return, however, the employee is guaranteed a defined amount in benefit payments **at retirement**. This defined amount continues for life, is based on years of service and final average salary, and may also be increased by a cost-of-living adjustment after retirement. The employee bears no risk since the entire burden for accumulating enough dollars to cover the costs of these promised benefits is assumed by the employer/sponsor. Younger employees who leave before retirement receive benefits that are substantially less valuable.

The Advantages of Defined-benefit Plans for Employers

Defined-benefit plans have a number of characteristics that employers find attractive. For example:

- They assist employers in retaining quality employees
- They fund income-protection benefits at disability and death
- They provide a targeted amount of retirement income for life to meet the employee's retirement income needs
- They may cost less than defined-contribution plans since they pay less valuable benefits to younger employees
- They can be designed to maintain fixed or steady contribution rates to assist the employer in budgeting

Plans Designed to Benefit Short-term Employees

On the other hand, defined-contribution plans offer fewer advantages to long-term employees. The value of these plans depends exclusively on the dollars contributed to the plan and the earnings gained from investments. Because years of service and final average salary are not directly rewarded, defined-contribution plans can offer provisions highly attractive to short-term employees.

Defined-contribution plans transfer control from the employer to the employee. Participants determine the amount of their contributions (subject to plan provisions and IRS limitations), the choice of investments and the way dollars are distributed at retirement. However, along with control comes the assumption of risk.

Defined-contribution Plans Have Advantages for Short-term Employees

- Portable
- Equitable
- Easy to understand
- Certain and predictable costs
- Investment return directly improves benefits
- Consistent with “deferred wages” concept
- Highly valued
- Employee expected to manage risk through investment options

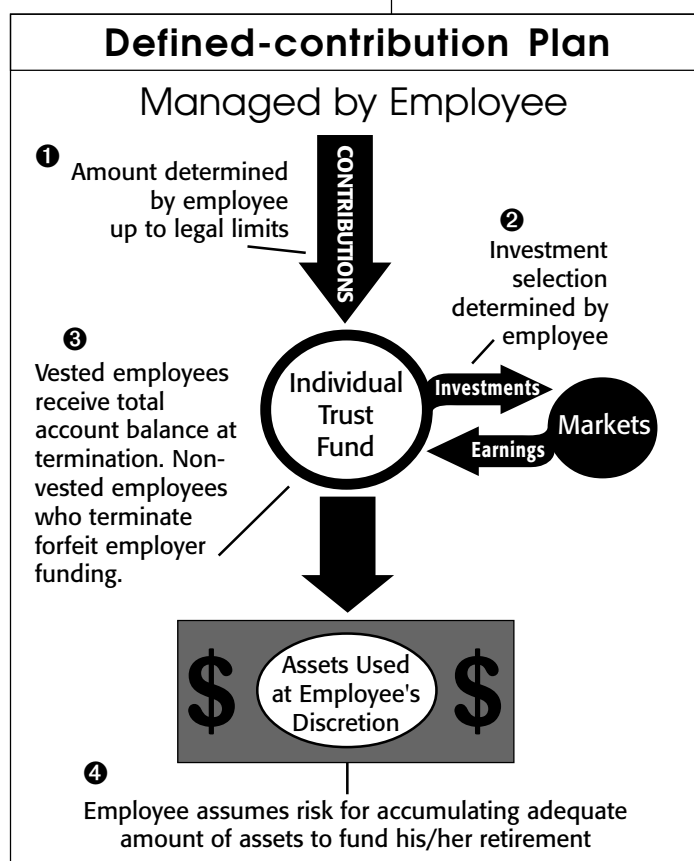
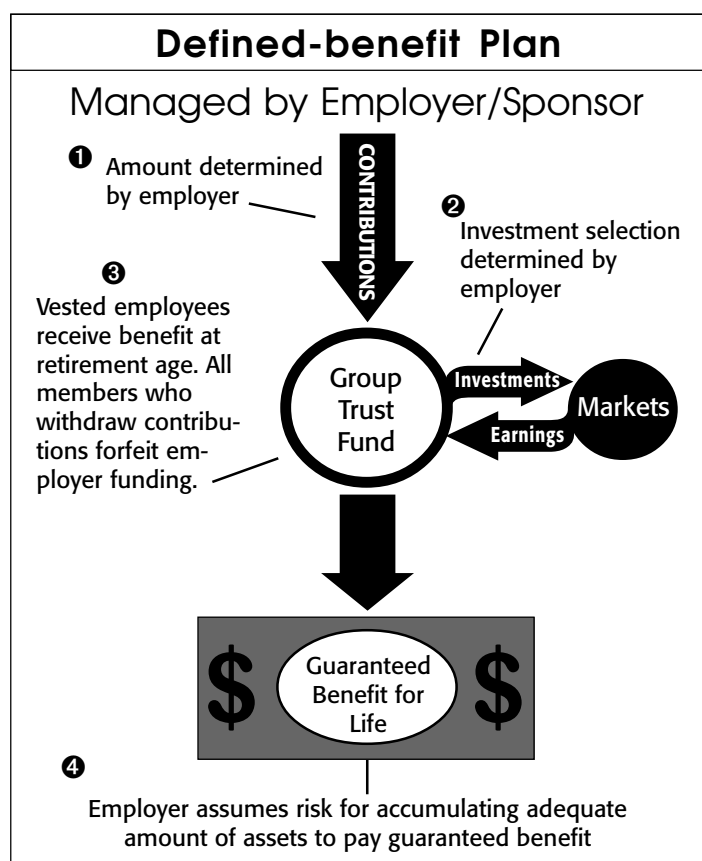
The Advantages of Defined-contribution Plans for Employers

Defined-contribution plans also contain features that are advantageous for employers. The most significant advantage being that defined-contribution plans place the responsibility of accumulating the dollars to cover the costs of retirement directly on the employee. This shift eliminates the employer’s long-term risk. In addition, a defined-contribution plan guarantees predictable costs for the employer which simplifies budgeting. Employers also find that participants understand and highly value a defined-contribution plan.

A Summary of Defined-benefit and Defined-contribution Plans

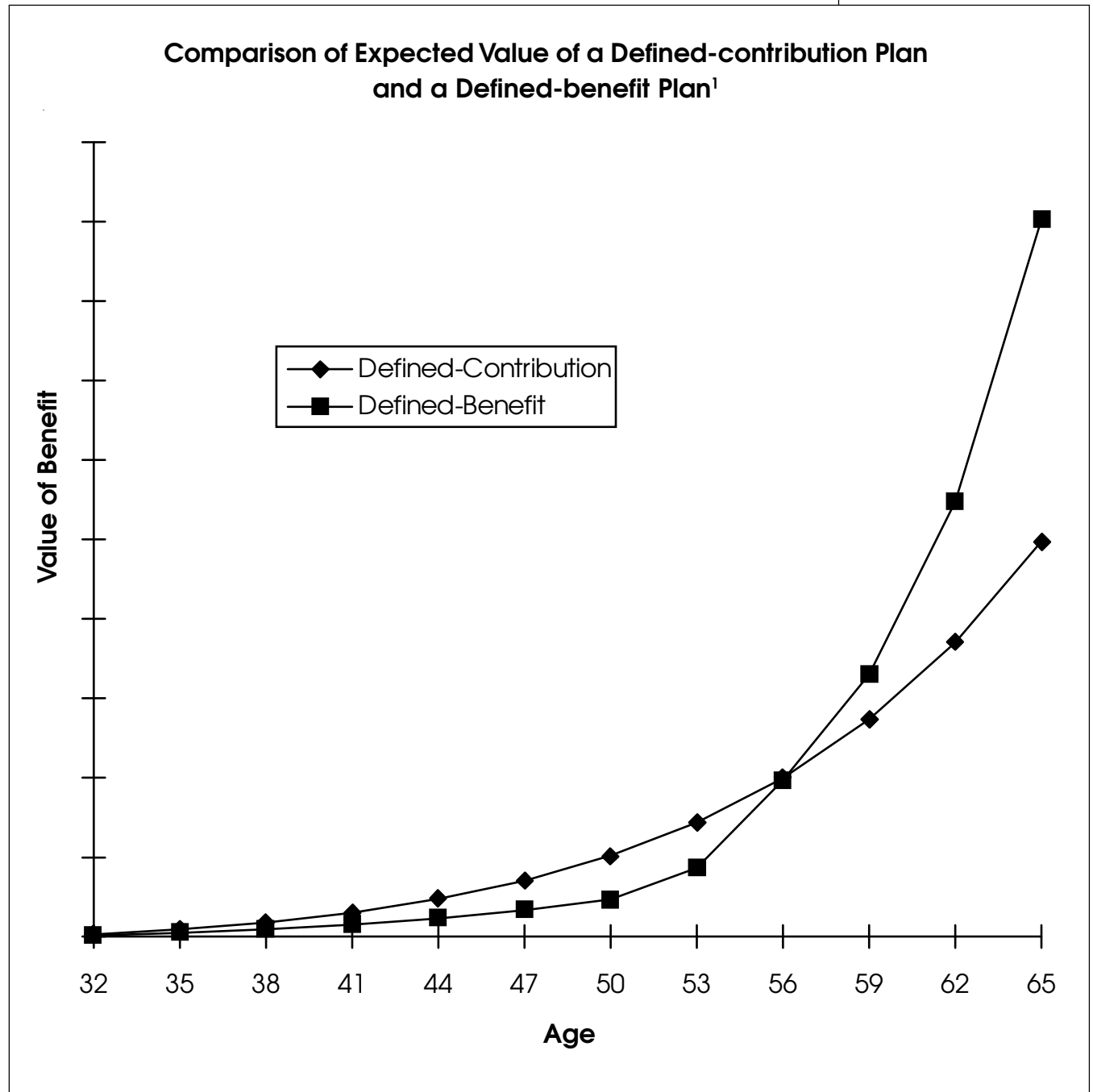
As the charts below illustrate, defined-benefit plans and defined-contribution plans differ in the areas of control and risk.

A fundamental question emerges in the debate between advocates of defined-benefit plans and defined-contribution plans: which approach produces the higher benefits? The graphs on the following two pages show that the answer



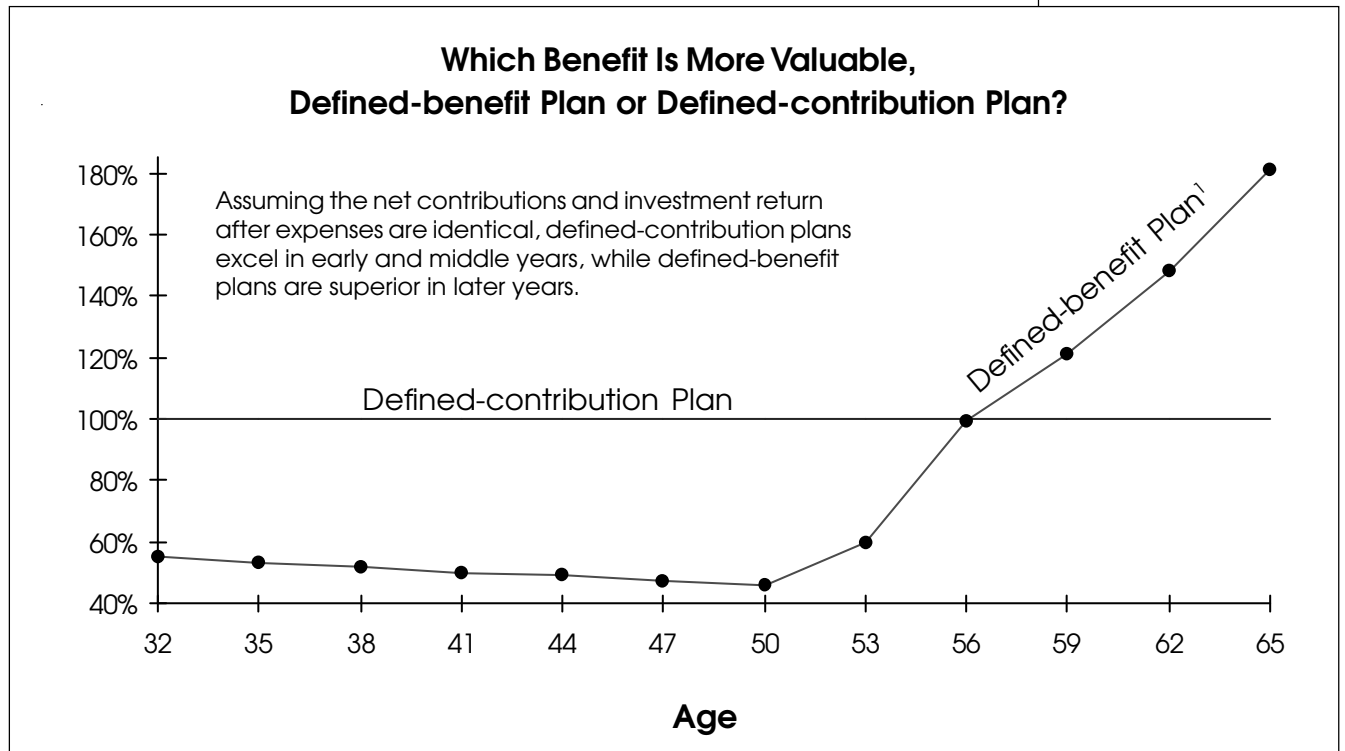
depends on the characteristics of the participant. The defined-contribution plan favors young, short-term employees, especially when capital markets are doing well. Higher-than-expected investment returns translate into immediate increases in the value of the participant's account. The defined-benefit plan, which typically generates superior investment performance because it is professionally managed, may use higher-than-anticipated earnings to reduce costs or increase benefits. It pays a benefit for life and, in general, works exceptionally well for the long-term member.

The graphs show that for an employee hired at age 31, the value of a defined-contribution plan exceeds that of a defined-benefit plan up to age 56, *assuming the net contributions and investment return, after expenses, are identical*. However, after approximately age 56, a defined-benefit plan begins to outperform a defined-contribution plan. The second graph also illustrates the widening gap between benefit values as a participant approaches retirement.



¹ For an illustration of SDRS' value in relation to defined-benefit plans and defined-contribution plans, see page 14.

The comparisons shown in the graphs on the previous page and in the one below make it clear that any system that consists of both long-term and short-term employees will require an alternative approach if it is to consider the needs of all its participants.



¹ For an illustration of SDRS' value in relation to defined-benefit plans and defined-contribution plans, see page 14.

SDRS Blends Benefits for Long-term and Short-term Members

At its inception, SDRS' fundamental mission was clear: to provide a high level of retirement benefits to long-term,

career employees. A benefit formula that calculated benefits for all years of service based on recent high years of salary and a provision that required members who withdrew from the system to forfeit all employer contributions tilted the plan's design toward the member who continued with SDRS until retirement. The emphasis was on creating an incentive for experienced public workers to stay with their employer.

But even in its earliest years, SDRS contained provisions that took into consideration the special needs of its members who were disabled or the needs of their surviving families if they died. Moreover, the board's recommendations on benefit improvements over the 30-year period reflect an awareness that the membership is highly diverse. The board recommended improved early retirement benefits, benefit improvements to retirees as well as active members, increases in the cost-of-living adjustment, and indexing of benefits for members who terminate before retirement.

The most significant provision for short-term members, however, is the Portable Retirement Option (PRO) that first became effective in 1995, and was then expanded in 1998. Available to all members, the PRO incorporates one of the most attractive features of defined-contri-

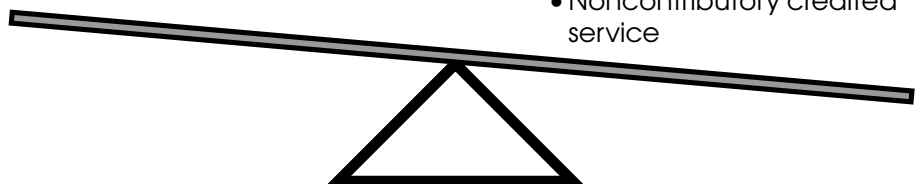
Though Favoring Long-term Employees, SDRS Also Benefits Short-term Employees

Short-term Employees

- Portable Retirement Option
- Disability benefits
- Pre-retirement survivor benefits
- Early vesting
- Indexing of benefits before retirement date

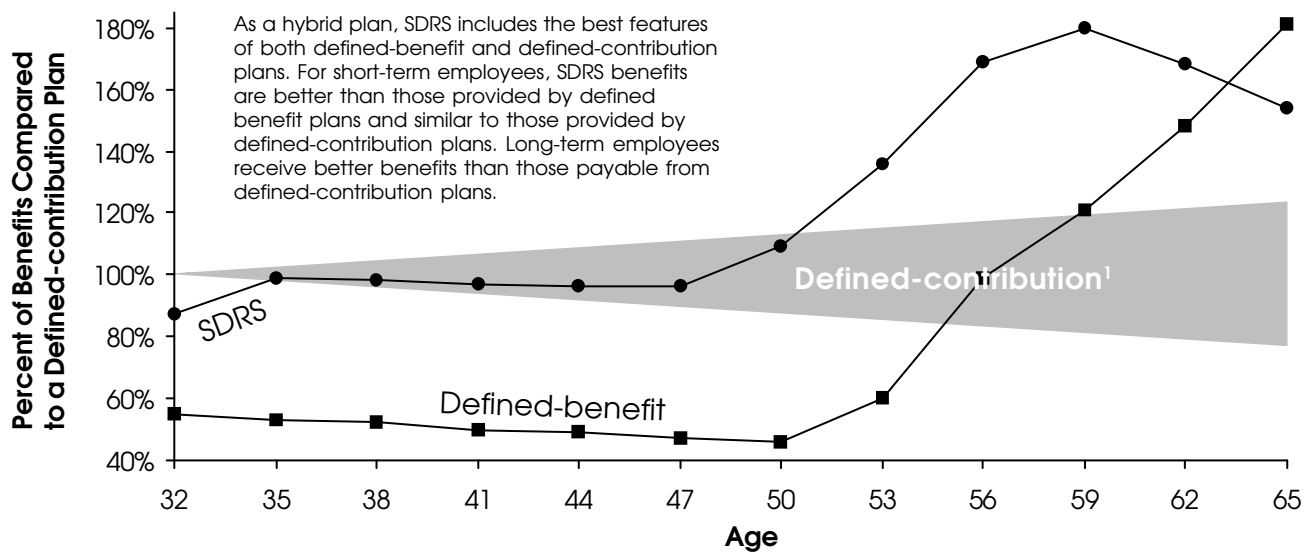
Long-term Employees

- Final Average Pay formula
- Regular and Special Early retirement eligibility and benefits
- Post-retirement survivor benefits
- Improvement factor
- Member and employee contribution guarantee
- Credited service buy-back
- Noncontributory credited service



bution plans into SDRS. Portability, or the ability to carry a retirement plan from job to job, has become critical to recruitment as employees become more mobile. The PRO offers that portability to its members by giving them the choice of withdrawing both employer and employee contributions, plus interest, in lieu of SDRS guaranteed lifetime monthly retirement benefits. This option equals the portability available under defined-contribution plans and far exceeds that of defined-benefit plans. Since portability is especially important to short-term employees, for this group the PRO constitutes a major improvement.

Comparison of SDRS Benefit Values to Other Plan Designs



¹ The value of a defined-contribution plan will vary based on a plan's investment experience.

The provision also maintains the blend of short-term and long-term benefits at a ratio of about one to three. For every one dollar in benefit values targeted to short-term employees, there are approximately three dollars of value directed to long-term employees. The board of trustees' adoption of this proportion favoring long-term employees flows from its commitment to a single overriding mission: to guarantee every career employee a retirement benefit that in combination with Social Security will replace 70 to 85 percent of pay.

Why SDRS' Hybrid Plan is Superior to Both Defined-contribution and Defined-benefit Plans

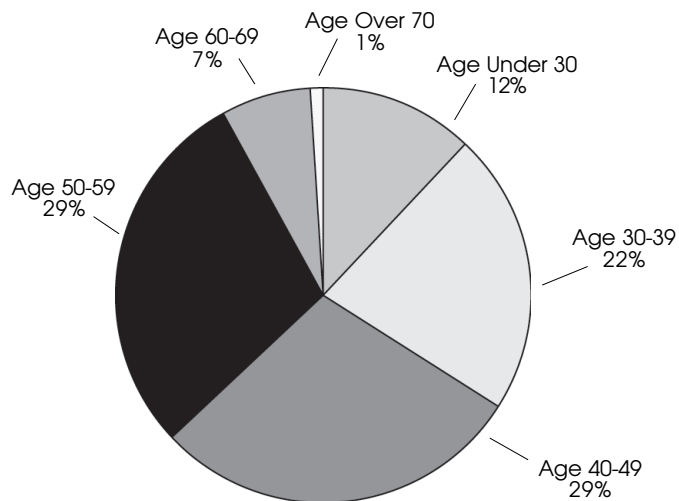
Pure defined-benefit plans and pure defined-contribution plans fall on opposite ends of the spectrum in retirement system design. They favor either career-oriented,

long-term employees or young, short-term employees. SDRS, however, consists of a membership that includes young and old, short-term and long-term employees.

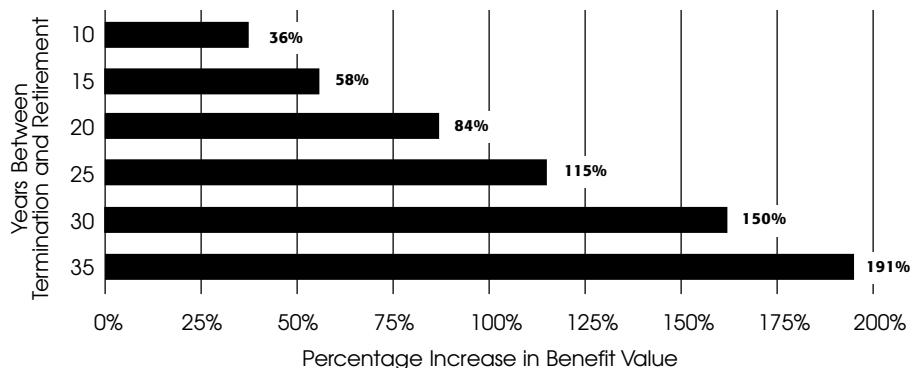
Because of this mix, SDRS' hybrid plan combines design features advantageous to all segments of the membership. Of particular importance is the system's capability to provide a meaningful retirement benefit to any member who is vested, even if their years of service are limited. Since SDRS increases the benefits of terminated, vested members by 3.1 percent each year, the value of their SDRS benefit rises steadily from the time they leave their job until retirement.

This plan provision works equally well with members who already have a defined-contribution plan prior to

SDRS: Active and Inactive Membership by Age



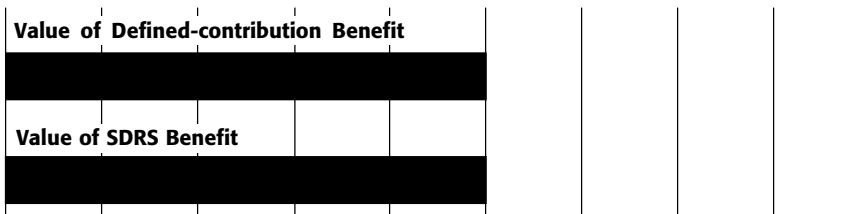
Indexing Boosts Retirement Benefit for Terminated Employees Who Remain in SDRS



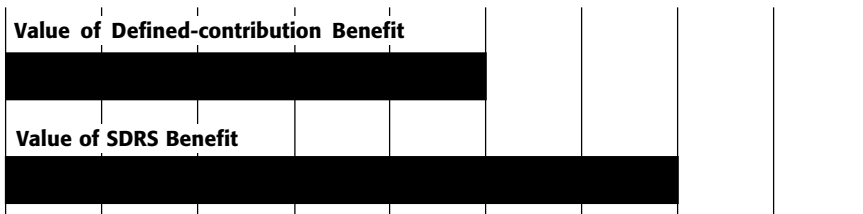
joining SDRS and intend to return to those plans after three years of credited service (the minimum for vesting in SDRS lifetime benefits).¹

All SDRS members who stay at least three years will receive benefits that are at least equal in value to those of a defined-contribution plan. For example, as the first graph below illustrates, a member entering SDRS at mid-career (age 40) and staying five years will earn a benefit equal in value to the dollars that could be accumulated in a defined-contribution plan. The second graph shows that the value of the benefit of a member entering SDRS at age 45 and staying five years will exceed by 24 percent the dollars that could be accumulated in a defined-contribution plan.²

The Value of SDRS Benefits for a Member Joining at Age 40 and Staying 5 Years Equals the Value of a Defined-contribution Plan



The Value of SDRS Benefits for a Member Joining at Age 45 and Staying 5 Years Exceeds the Value of a Defined-contribution Plan By 24%



With the addition of the PRO for all members, SDRS has added even greater flexibility and benefits to its plan. Even new members who do not remain in the system for three years will be eligible for a PRO benefit equal to a refund of 75 percent employer contributions plus all of their employee contributions and credited interest.

¹ Participants of any retirement system, including SDRS, who withdraw from the plan prior to vesting forfeit the right to any future benefit. SDRS also vests employees in 75 percent of employer's contributions immediately, and 100 percent after three years.

² Both graphs assume that net contributions and investment return after expenses are identical.

Why Making SDRS Optional for All Members Won't Work

Given the differences between defined-benefit plans and defined-contribution plans, it would

seem that employees should have the option to choose the plan they believe to be most advantageous. Those who favor this approach cite the following arguments:

- It empowers employees by giving them the right to choose their own plan
- It does not increase employee or employer costs
- It avoids the requirement for policy makers to favor one plan over the other
- It creates competition for retirement investments

In fact, these arguments do not stand up under close scrutiny. For example, the wisdom of offering newly hired employees a choice between two very different economic alternatives is questionable. The chance that these employees would make uninformed or misguided decisions would be high unless participating employers offered significant education about the likely economic results of each choice.

In addition, contrary to what supporters of an optional plan may say, there are additional costs associated with an optional approach, including increased administrative expenses, employee education programs, and most significantly for plans like SDRS, costs resulting from the following factors:

1. SDRS requires a portion of the current contributions to amortize unfunded obligations. Consequently, the loss of contributions from employees (future as well as current) who did not elect to participate in SDRS' present plan would be substantial.

2. Part of SDRS' strength comes from a mix of employee characteristics and risks that results from all new employees becoming SDRS members. If the current SDRS plan became optional, it is likely that adverse selection would change the mix, making the plan more costly. New employees choosing SDRS would probably have the following characteristics:

- Higher age at employment
- Greater likelihood of career employment
- Poorer health (disability exposure)
- Higher income
- Greater potential for advancement and salary growth

Combined, these costs would, in all probability, be great enough to threaten the system's ability to maintain current benefits at the present rate of contributions.

Consider the effect of only one of the factors listed above. If optional participation caused an increase of ten years in the average age of a new member, SDRS' costs would ultimately increase by 15 percent per year. The cost of all the factors can only be speculated but would clearly not be affordable at current contribution levels.

Key Positions Adopted by the SDRS Board of Trustees

The SDRS Board of Trustees administers the system and makes recommendations for changes in accordance with the following key positions:

- A consolidated retirement plan is the most cost-efficient, equitable approach to providing retirement benefits to South Dakota's public employees. The board will support proposals that strengthen consolidation and oppose those that weaken it.
- By statute, the SDRS Trust Fund shall be used exclusively for the benefit of members and their beneficiaries. The board will support investment strategies that advance this statutory requirement and oppose proposals that compromise the integrity of the trust fund.
- The board establishes long-term goals for SDRS benefits in accordance with national practices and member needs.
- The board is committed to providing income-replacement benefits in accordance with its long-term goals that give SDRS members and their families the opportunity to achieve financial security at retirement, disability or death.
- The board's long-term goal of replacing 70 to 85 percent of pay for full-career members when combined with Social Security is a primary goal. Employers are expected to make additional contributions on compensation above the Social Security taxable wage base to attain this goal for all Class A career members.
- Guaranteed monthly lifetime benefit payments are consistent with SDRS' mission to provide continuous income throughout a member's retirement years.
- The board will only support future benefit improvements if its financial guidelines for improving benefits are met and if those benefits are in accordance with its adopted long-term goals.

- The board will not propose benefit improvements to SDRS that create unfunded liabilities. Instead, SDRS has created a Reserve for Funding of Long-term Benefit Goals, which is funded when experience is favorable. The Reserve is used to pre-fund proposed benefit increases and acts as an additional cushion in the event of an unfavorable market or investment experience.
- When SDRS' investment experience is favorable, benefit increases for all SDRS active and retired members are proposed. Such increases will be for prior service only.
- The present ratio between benefits for long-term and short-term members is appropriate. The boards' recommendations for future benefit improvements will seek to maintain this ratio.
- There are compelling reasons for the existence of Class A and Class B membership groups within SDRS. The board will oppose any proposal to eliminate or combine these classifications.
- The SDRS board considers the actuarial soundness of SDRS its primary responsibility. The following funding targets have been established:
 - Funding Period – 30 years, or less
 - Funded Ratio – 95 percent, or better
- Each trustee is responsible to represent the best interests of the system, considering all employer and employee members, as well as representing the interests of the trustee's respective constituent group.
- A decision by the majority of the board is official board policy.
- In exercising its fiduciary and managerial responsibilities for the system, the board must retain appointing and supervisory authority over its administrator as well as the authority to set compensation.
- The board is committed to providing employer and employee members with the best possible customer service.
- Optional participation in retirement plans results in a mix of ages, health conditions, salary levels and years of service that adversely affects the financial strength of a system. The board supports mandatory participation in SDRS and will oppose any modification that would make participation in SDRS optional.

Over the last 30 years, the board has initiated a wide range of changes in both plan provisions and benefit levels. This history of change has been possible because of the vision and long-term cooperation of the Retirement Laws Committees and the Legislature. The result of this effort is a consolidated plan that provides quality benefits at an employer cost well below the national average.

Appendix A: History of Changes in Basic Plan Provisions

Provision	Status In 1974	Benefit Change
Benefit Formula <ul style="list-style-type: none"> Class A Standard 	1.0%	1982 — 1.1% 1986 — 1.2% 1989 — 1.25% 1991 — 1.30% 1994 — 1.30% / 1.40% (for applicable years) 1997 — 1.40% prior to 1997/1.30% thereafter 1998 — 1.475% prior to 1998/1.30% thereafter 1999 — 1.55% prior to 2000/1.30% thereafter 2000 — 1.625% prior to 2002/1.30% thereafter 2002 — 1.625% prior to 2002/1.55% thereafter
<ul style="list-style-type: none"> Class B Public Safety 	2.0%	1994 — 2.0% / 2.10% (for applicable years) 1997 — 2.10% prior to 1997/2.0% thereafter 1998 — 2.175% prior to 1998/2.0% thereafter 1999 — 2.25% prior to 2000/2.0% thereafter 2000 — 2.325% prior to 2002/2.0% thereafter
<ul style="list-style-type: none"> Class B Judicial 	3.333% / 2.0%	1994 — 3.333% / 3.433% (for applicable years) 2.0% / 2.10% (for applicable years) 1997 — 3.433% prior to 1997/3.333% thereafter 2.10% prior to 1997/2.0% thereafter 1998 — 3.508% prior to 1998/3.333% thereafter 2.175% prior to 1998/2.0% thereafter 1999 — 3.583% prior to 2000/3.333% thereafter 2.25% prior to 2000/2.0% thereafter 2000 — 3.658% prior to 2002/3.333% thereafter 2.325% prior to 2002/2.0% thereafter
Class A Retiree Benefit Formula	Variable	Standard — Alternate 1982 — 1.0% – 2.0% 1987 — 1.05% – 2.0% 1988 — 1.1% – 2.0% 1989 — 1.25% – 2.0% 1991 — 1.30% – 2.0% 1994 — 1.30%/1.40% (for applicable years) – 2.0% 1997 — 1.40% prior to 1997/1.30% thereafter – 2.0% 1998 — 1.475% prior to 1998/1.30% thereafter – 2.0% 1999 — 1.55% prior to 2000/1.30% thereafter 2.25% prior to 2000/2.0% thereafter 2000 — 1.625% prior to 2000/1.30% thereafter 2.325% prior to 2002/2.0% thereafter 2002 — 1.625% prior to 2002/1.55% thereafter 2.325% prior to 2002/2.25% thereafter
Improvement Factor	2% Simple	1978 — 2.0% Compound (Indexed) 1982 — 3.0% Compound (Indexed) 1988 — 3.0% Compound 1993 — 3.1% Compound 1998 — 3.1% Compound (Prorated)
Early Retirement <ul style="list-style-type: none"> Class A 	Early Retirement: Age 55 with 6% per Year Reduction	1978 — Reduction Decreased to 3% per Year 1986 — Rule of 85 (Age 60) 1989 — Removed "at work" Limitation 1991 — Rule of 85 (Age 58) 1993 — Rule of 85 (Age 55)
<ul style="list-style-type: none"> Class B Public Safety 	Early Retirement: Age 45 with 6% per Year Reduction	1978 — Reduction Decreased to 3% per Year 1982 — Early Retirement Age for New Members: Age 50 1989 — Early Retirement: Age 45 for All Class B Public Safety Members 1991 — Age 50/25 Years of Service 1998 — Rule of 75 (Age 45)
<ul style="list-style-type: none"> Class B Judicial 	Early Retirement: Age 55 with 6% per Year Reduction	1978 — Reduction Decreased to 3% per Year 1990 — Rule of 80 (Age 55)
Optional Spouse Coverage	1.0% of Compensation	1978 — .8% of Compensation 2004 — 1.2% of Compensation

History of Changes in Basic Plan Provisions/Continued

Provision	Status In 1974	Provision Change
Final Average Compensation Caps	Last quarter cap 125% of any previous quarter; four quarter average cap 115% of any previous quarter	2004 — Last quarter cap = 115% four quarter average cap = 110% 2005 — Last quarter cap = 105% four quarter average cap = 105%
Special Pay Plan	Termination pay made directly to member with SS, SDRS and income taxes deducted	2004 — Termination pay to Special Pay Plan without SS, SDRS or income tax deductions
Purchasing Uncredited Service • Class A • Class B Public Safety • Class B Judicial	Buy at 10% of compensation Buy at 12% of compensation Buy at 12% of compensation	1989 — Buy at 7.5% of compensation 2002 — Buy at 9% of compensation 2004 — Buy at rate dependent on age and varying from 12% to 30% of compensation 1978 — Buy at 16% of compensation 1982 — Current members maximum of 20% of compensation; new members 16% of compensation 1989 — Buy at 12% of compensation 2004 — Buy at rate dependent on age and varying from 16% to 40% of compensation 1978 — Buy at 16% of compensation 1982 — Buy at maximum 20% of compensation 1989 — Buy at 13.5% of compensation 2004 — Buy at rate dependent on age and varying from 18% to 45% of compensation
Contribution Rate • Class A • Class B Public Safety • Class B Judicial	5% 6% 6%	2002 — 6% 1978 — 8% 1982 — For current members increasing 1/8 of 1% to maximum of 10%; for new members 8% 1989 — 8% for all members 1978 — 8% 1982 — 1/8 of 1% to maximum of 10% 1989 — capped at 9%
Normal Retirement Age for Class B Public Safety	Age 55	1982 — New members age 60 1989 — Age 55 for all members
Refund of Accumulated Contributions	Member contributions only	1986 — guaranteed refund of the balance of all employer/member contributions if member dies after retirement. 1995 — Portable Retirement Option (PRO) — For PRO members withdrawing prior to retirement, a refund of all or a percentage of employer/member contributions based on years of service 1998 — Portable Retirement Option (PRO) — For all members withdrawing prior to retirement, a refund of all or a percentage of employer/member contributions based on years of service
Interest on Accumulated Contributions	5% on member contributions only	1986 — No greater than 90% of the 91-day T-Bill rate; 5% minimum, 10% maximum 2004 — No greater than 90% of the 91-day T-bill rate; maximum, the actuarially assumed rate of investment return,

History of Changes in Basic Plan Provisions/Continued

Provision	Status In 1974	Provision Change
Retire/rehire <ul style="list-style-type: none"> • Normal or Special Early Retirement <ul style="list-style-type: none"> • Early Retirement 	<ul style="list-style-type: none"> —Benefits, including the COLA, paid during reemployment without adjustment —Rehired member treated as continuing member —Add-on benefit paid at re-retirement considers all periods of employment <ul style="list-style-type: none"> —Benefits, including the COLA suspended during reemployment —Rehired member treated as continuing member —Add-on benefit paid at re-retirement considers all periods of employment 	2004 — Benefits paid during reemployment but COLA eliminated (except for Class B Public Safety member who is rehired as Class A member) —Rehired member treated as new member —Add-on benefit paid at re-retirement considers reemployment period only —Retired/rehires prior to July 1, 2004 grandfathered under current law 2004 — Benefits, including the COLA, suspended during reemployment —Rehired member treated as new member —Add-on benefit paid at re-retirement considers reemployment period only
Compensation Basis for Benefit Calculations	<ul style="list-style-type: none"> —Retirement benefit based on final average compensation (three-year average) —Disability and survivor benefits (for members who die before retirement) based on highest one-year pay 	2004 — All SDRS benefits (retirement, disability and survivor) based on final average compensation
Eligibility Requirements <ul style="list-style-type: none"> • Vested Retirement Benefits <ul style="list-style-type: none"> • Disability Benefits 	<ul style="list-style-type: none"> —Five years of credited service that includes purchased service <ul style="list-style-type: none"> —Five years of credited service unless disabled in an accident at work, then no specific amount of credited service is required 	1998 — Three years of credited service including purchased service 2004 — Three years of contributory service, does not include purchased service 1998 — Three years of credited service including purchased service 2004 — Three years of contributory service since reentry into SDRS unless disabled in an accident at work, then no specific amount of contributory service is required

Notes _____



A Statement of Principles and Direction for the Plan Design of SDRS is published with funds provided through the contributions of teachers, school boards, state government, state employees, county commissions, county employees, municipal governments, and municipal employees.

The South Dakota Retirement System fully subscribes to the provisions of the Americans with Disabilities Act of 1990.



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